Corporations

The Friendly Neighborhood Trade Commission

By Montgomery N. Kosma

In some sectors of our economy, the rise of Internet commerce has prompted a dramatic response: do anything possible to keep out online price cutters! Many traditional local vendors feel threatened by online merchants who can take advantage of scale economies and avoid the overhead of an in-state storefront. In many instances, they have turned to the state government for legislative or administrative protection from that competition. Such measures are often hostile to free markets, limiting price competition and restricting consumer choice and convenience. They also clash with the constitutional principle of federalism which enjoins the states from unjustifiably interfering with interstate commerce. Under the leadership of Chairman Timothy Muris, the Federal Trade Commission has recognized these trends and responded strongly with the voice of national, federal competition policy in cases where consumer interests appear to be threatened.[1]

For some time, the principal devotees of federalism have focused on policy initiatives and litigation to restrain the federal government's encroachment on the rights, powers, and sovereignty of the states. But there is a flip side to federalism that requires states to refrain from interfering with national interests committed to federal authority. When local or regional conduct is at issue, there may be some value to having heterogeneous legal standards that result from each state operating as an independent "laboratory of democracy." However, when it comes to national or international economic regulation, leaving legal rules up to the experimentation of the states invites rent-seeking, inefficiency, and uncertainty, and leads almost inevitably to a system in which the most restrictive state regulations define the *de facto* national standard. One can easily imagine the chaos that would ensue if, for example, the states could individually regulate the issuance and enforcement of patents.

The Constitution provides some assistance in countering protectionist actions by the states. As James Madison recognized in Federalist No. 10, one of the principal justifications for an extended republic was to reduce the power of factions seeking government action in order to advance their own interests rather than the broader public good. Consistent with this principle, ever since *Gibbons v. Ogden* was decided in 1824, the Supreme Court has (rightly or wrongly) found within the Constitution's Commerce Clause a "dormant" restriction against state regulation of interstate commerce. The Court has applied this doctrine as a limit on the states' police power. State laws, regulations, and administrative actions that nakedly discriminate against out-of-state competitors are generally subjected to strict scrutiny, and in most cases have been struck down. Naturally, such a legal standard creates incentives for cleverness. Thus, most dormant commerce clause cases today involve facially neutral regulations or actions that ostensibly serve some legitimate local public interest, but which have a disparate impact upon out-of-state competitors. In such cases, the Court applies a balancing test, asking whether the burden on interstate commerce is clearly excessive in relation to the putative local benefits.

Nevertheless, litigation under the dormant commerce clause is frequently inadequate to protect competition. A clever state or municipality can cloak protectionist measures in the garb of legitimate public interest, making judicial challenge difficult and costly. Because of this need for justification, some of the most pernicious protectionist measures affect businesses that have been traditionally subjected to state licensing for legitimate reasons of public health or safety. Because states generally enjoy immunity from the antitrust laws pursuant to the Supreme Court's 1942 decision in *Parker v. Brown*, Courts are chary of upsetting such regulations. Notwithstanding *Parker*, principles of federalism counsel deference to states, and principles of separation of powers counsel deference to legislative or administrative policymakers. Litigation is a costly and risky process, and even if judicial relief can be obtained, it may not be sufficient or timely enough to redress all of the harm.

Enter the FTC. Chairman Muris and Ted Cruz, the Director of the FTC's Office of Policy Planning, have recognized that their agency can wield not just the power of compulsion, but also the power of persuasion. Where it has judged that the threatened harm to competition (*i.e.*, decreasing consumer choice or increasing prices) outweighs the supposed public benefits ascribed to a proposal, the FTC has taken affirmative steps to make its views known by filing letters, comments, and testimony in state regulatory proceedings.

For example, Connecticut's Board of Examiners for Opticians is conducting a declaratory proceeding to determine whether Connecticut law requires optician licenses for all vendors that sell contact lenses in the state. Supporters of the requirement contend that patients should be required to obtain contact lenses from a licensed provider – typically, the doctor who prescribes the lenses – in the interest of patient health. Medical supervision of the use of contact lenses is important to prevent eye problems, to ensure that patients adhere to doctors' usage instructions and to spot emerging health problems at an early stage. On the other hand, a licensing requirement would prevent most stand-alone sellers of replacement contact lenses (such as 1-800-CONTACTS) from conducting business within the state. The FTC provided written comments and oral testimony to the

Board, contending that the proposed interpretation would severely restrict competition by Internet, telephone, and mail order sellers of contact lenses, and that the purported health interests are already adequately protected by other state and federal regulations, such as the requirement for a doctor's prescription. Thus, the proposal would harm consumer welfare by increasing prices and reducing convenience, with little or no offsetting public benefit. Although Connecticut has not yet issued a decision in its proceeding, at least some of the barriers to competition may be coming down: according to FTC staff, Alaska changed its policy to allow online contact lens sales after reading the FTC filing in the Connecticut proceeding.

As another example, the FTC has recently opposed state actions that effectively limit the ability of Internet-based mortgage lenders to conduct business in North Carolina and Rhode Island. In North Carolina, the State Bar adopted two opinions requiring the physical presence of attorneys at closings for all residential real estate purchases and refinancings. In Rhode Island, the House of Representatives was considering a bill to prevent non-lawyers from competing with lawyers to perform real estate closings. The FTC filed comments with authorities in both states, and provided oral testimony in North Carolina, noting the rule's disparate impact on online mortgage brokers who more frequently rely upon "lay" closers rather than attorneys with a physical presence in the state.[2] In each case, the FTC pointed out the lack of support for the assumption that consumers are at risk in transactions without attorneys, and marshalled empirical evidence based on the experience in other states to demonstrate that the proposed rules could raise closing costs by $150 to $500 per transaction. As a result, the North Carolina State Bar has promulgated proposed formal ethics opinions substantially reversing its prior position. At last report, the Rhode Island bill had been returned to committee for further consideration.

Although to date the FTC has been reluctant to get involved in dormant commerce clause litigation, it has been closely following various cases and recently held a public workshop relating to possible anticompetitive efforts to restrict competition on the Internet. The FTC also filed an *amicus* brief in a federal court case in which private plaintiffs, represented by the Institute for Justice, challenged Oklahoma's requirements that sellers of caskets be licensed funeral directors. In its filing, the FTC clarified that the purpose of the FTC's Funeral Rule was to permit sellers other than funeral directors to compete for casket sales, and that the rule did not support the state's position that all suppliers of funeral goods should be subject to the same regulation. However, the FTC expressly declined to take any position on the merits of the dormant commerce clause and other arguments advanced by the plaintiffs. In the days ahead, we should see continued FTC interest in such cases, but unless something changes in its willingness to address constitutional issues, we should expect *amicus* involvement only when a case presents some element of traditional FTC interest or expertise (*e.g.*, a longstanding FTC consumer protection rule or a doctrine like *Noerr-Pennington* immunity from antitrust liability for conduct that constitutes governmental petitioning).

In his recent remarks at the Federalist Society's National Lawyers Convention, Chairman Muris recognized that "a well-ordered federalist system must be concerned not just with an overreaching federal government, but also with preventing states from encroaching on each other." The advent of online commerce has brought with it a new wave of proposals for states to protect local vendors at the expense of Internet-based competitors – and at the expense of competition. The FTC's affirmative efforts to inject itself into these debates as an advocate for competition adds a powerful voice to address national interests. And significantly, it moves this particular federalism debate somewhat away from the realm of constitutional law. Because of countervailing federalism principles and the potential consequences of an activist approach to the Constitution, courts have been naturally hesitant to strike down state regulations as unconstitutional under the dormant commerce clause. Indeed, good economic policy without more is probably an insufficient basis for such coercive judicial action. So it is encouraging to see the FTC making efforts to advocate sound economic policy and thereby defend the competitive marketplace, although it is probably too soon to judge how effective its efforts will be.

In cases or other public disputes that implicate such issues, the wise advocate will remember that the FTC continues to seek opportunities to speak as an advocate for competition, and its opinion can carry substantial weight if and when placed on the scales of justice. Ted Cruz has specifically invited the public to contact the FTC's Office of Policy Planning regarding situations in which the persuasive rather than the coercive weight of the agency might effectively be brought to bear. We should expect to see FTC involvement in more cases, and in more types of cases. Among other things, be on the lookout for the FTC to intervene in a consumer class action, arguing that a settlement ostensibly in consumers' interests is actually hostile to free markets.

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Footnotes

[1] *See Possible Anticompetitive Efforts to Restrict Competition on the Internet:* Federal Trade Commission Public Workshop (Oct. 8-10, 2002), available at http://www.ftc.gov/opp/ecommerce/anticompetitive/index.htm.

[2] The FTC also recently filed comments with the American Bar Association's Task Force on the Model Definition of the Practice of Law, arguing that the ABA's broad definitional proposal would have a chilling effect on competition by lay service providers and ultimately raise prices to consumers.